

**American Insurance Association – Sean McManamy**  
**Testimony at Michigan OFIS Public Hearing**  
**June 4, 2002 – Cadillac, MI**

We applaud Commissioner Fitzgerald for holding this series of public forums on credit-based insurance scoring. Despite ongoing efforts by the insurance industry to educate policyholders about this issue, misunderstanding and misinformation persist in Michigan and around the country. My goal in my short testimony today is to shine just a little more light on an issue that still takes a number of people by surprise.

Whether they live in Cadillac or Flint, Marquette or Detroit, insurance consumers across the state of Michigan are feeling the effects of what is commonly referred to as a hard market.

There are several reasons for this – almost a decade of low prices, multi-million dollar settlements brought on by frivolous lawsuits, increased fraud throughout the system, and investment portfolios hurt by the recent recession. These, combined with nearly \$50 billion in losses stemming from the tragic events of September 11, have led insurers in Michigan and every other state to adjust premiums upward for nearly all lines of personal and commercial insurance. This is done to make certain that insurers continue to have the cash reserves they need to pay their policyholders' claims fully and quickly.

Despite this trend, millions of Michiganders are paying lower premiums than their neighbors because their insurer has deemed them eligible for a discount based on their personal history of financial responsibility – their "credit-based insurance score."

In the late 1980s, Fair, Isaac, the country's leading developer of credit scoring models for the lending industry, began to study the relationship between credit

characteristics and insurance loss ratio performance. Fair, Isaac analyzed personal automobile and property policies and compared the loss history of the policyholders with specific characteristics in their individual credit histories. What Fair, Isaac found, and what other research has consistently confirmed, is that the manner in which an individual manages his or her finances is highly predictive of that person's likelihood of making a future insurance claim. It is for that reason that credit-based insurance scores have become a prevalent tool for insurance companies.

For years, many insurance companies have offered "good student" discounts to young drivers who attain a certain level of success in the classroom. While a student's performance in the classroom does not have any direct bearing on her skill at driving a car, most people would agree that good grades are an indication of a responsible young person. Even though younger drivers are statistically far more likely to be involved in an accident than someone with more experience behind the wheel, insurance companies will discount the premiums of those young people who have demonstrated responsibility through their schoolwork. Think of credit-based insurance scores as statistically proven, good student discounts for adults.

So, how does it work? Take, for example, a 24 year old male driver from Cadillac. He's got a clean driving record, but through no fault of his own, he falls into the "dreaded" 16-25 year-old male category. But in his short adult life, despite the fact that he only makes \$20,000 a year, he's shown himself to be extremely responsible with his finances. He pays his bills on time and doesn't overextend himself by opening credit accounts he doesn't need. Thanks to credit-based insurance scoring, his insurer can give him a discounted rate based on individualized data that is within his control.

Discounts for credit-based insurance scores would be of even greater benefit to a 23-year-old male on the east side of Detroit, an area that has some of the highest

loss costs in the state. Under a traditional rating system, his rate might be negatively impacted by both his age, his gender and the fact that he lives in an area that produces high aggregate losses. But a good driving record coupled with a history of financial responsibility might qualify him for a significant premium discount.

AIA understands that using financial responsibility as a factor in insurance is new and, for some people, even counterintuitive. The industry is working diligently to promote educational efforts on the subject in Michigan and elsewhere. We encourage policyholders to ask their insurance company how, if at all, it uses credit in discounting their premium. And as always, if someone is unhappy with the premium their insurer has quoted them, they should absolutely shop around. That's the benefit of a competitive marketplace.

Finally, because of the provisions in the Essential Insurance Act, Michigan is already more restrictive than most any other state with regard to insurer use of credit. In other states, credit can be used to deny a person a policy. It can be used to cancel the policy of an existing customer and to raise the premiums of another. In Michigan, that's not the case. In Michigan, not one person has been denied insurance, had a policy canceled, or had a premium increased because of credit. Yet millions of Michiganders have seen their rates go down, in some cases significantly. To put it more simply, if the law were changed to prohibit insurers from offering discounts based on credit, it is entirely likely that while not a single Michigan consumer would see their rates go down, millions could see them go up.